Kentucky Agriculture Finance Corporation

Meeting Minutes

April 16, 2003

The Kentucky Agriculture Finance Corporation met at 9:00am on April 16, 2003 in the Old Capitol Annex in Frankfort, Kentucky.

Members Present:

Mr. Gordon Duke; Ms. Jane Jones; Ms. Sandy Ross; Dr. Harold Benson; Ms. Annette Crawford Walters; Mr. Wayne Hunt; Mr. Charles Miller; Mr. Bob D. Proffitt; Commissioner Billy Ray Smith

Members Absent:

Mr. Billy Joe Miles; Mr. Billy Hurd; Mr. Doug Lawson

Governor's Office of Agricultural Policy Staff Present:

Bruce Harper; John-Mark Hack; Jeff Harper; Joel Neaveill; David Bratcher; Gene Royalty; Edith Fultz

Guests:

Mr. Mark Farrow, General Council Kentucky Department of Agriculture
Ms. Ann Stewart, Kentucky Department of Agriculture

Commissioner Billy Ray Smith - Announced that the press was notified of this meeting and asked the secretary to call the roll.

Commissioner Smith – Welcomed everyone to the meeting and entertained a motion for approval of the Minutes of the February 19th meeting. Mr. Gordon Duke made a motion to approve; Dr. Harold Benson seconded the motion. The minutes were approved.

David Bratcher – told us that House Bill 541 passed in the house ninety-eight to zero in favor of passage; it got into the Senate and came out of the Senate Ag Committee with one negative vote which precluded it from being put on the consent calendar. It did work its way on to the orders of the day. It was then waiting to be voted on by the full Senate and it was just a matter of the bill being called up and put on the agenda for passage. It sat on the orders of the day for five days. We feel that there was no strong sentiment against what we were proposing in terms of changes to the legislation. We will want to go back to the 2004 session with another piece of legislation. In the interim, we have gone back and looked at the existing statute. From that, we have put together this near term plan and we feel that there are some things we can do in the short term. Probably the most difficult thing to accomplish is lending, especially to those who are not first time farmers. There are two definitions of applicant:

1. First Time Farmer – this had a very narrow definition – in HB 541 we had changed it to say first time farmer as defined by the tax code.
2. All others - maximum loan amount of $50,000; applicant must derive 75% of gross income from farming. We were really trying to get this changed and open that definition up to allow us to do agribusiness loans, and allow us to do larger loans for farmers who were not first time farmers.

The other area in the legislation was more administrative, to have KAFC attached for administrative purposes to the Finance and Administration Cabinet.

<u>Mr. Bratcher</u> initiated group discussion on the role we could be playing and whether we want to solicit funds from the Agricultural Development Board this calendar year. If we wait until the 2004 session, the legislation would not be effective until July 2004. Hopefully we can have the program up and going, have some things in place for the change of administrations in the Department of Agriculture and the Governor's Office and be able to demonstrate some applicability of programs as we go into the 2004 session.

Staff reviewed KRS 247and presented a near term plan for 2003 & 2004. The plan proposes establishing the Kentucky Agri-investment Trust. These funds would be invested (page one of the near term plan) as identified in the statute. KAFC would reinvest funds from the trust in other ways. We would attempt implementing the First Time Farmer program even with the existing restrictions in the statute. The existing restrictions say that the maximum income of the First Time Farmer (net income from all sources) in the year prior to the year that we make the loan cannot be more than $100 thousand. The bigger issue is going to be that for three years after the loan, 50% of their gross income must come from farming. He explained further.

He also told us that he hoped Jeff Hall and Butch Dunsmore from the Farm Service Administration (FSA) would come to this meeting and told us that he has spoken with them about the possibility of this corporation entering into a Memorandum of Agreement with FSA to be the certified lender at the state level for FSA's First Time Farmer Guarantee Program. We would be promoting their First Time Farmer Program and working in concert with them. The FSA Program will finance up to 40% of the loan for the First Time Farmer at a below market rate. They will guarantee up to 40% with a local lender.

Our overriding premise all along has been that we would like the Kentucky Agricultural Finance Corporation to be working through local banks or local lenders. We would hopefully seek a guarantee on the amount that the bank is lending. Then the Agricultural Finance Corporation and the bank could sell out the guaranteed portion, and that would allow us to continue to recycle those dollars as they keep coming back into the fund. Our interest rate would be less than the bank's rate so they would blend those rates together and the farmer would get a pretty good rate on overall cost of interest, which would be locked for the term of the loan. With the FSA program, they can generally lend up to 15 years on the First Time Farmer Program. The Federal Director of FSA has sent out a letter to all of the states asking the states to consider entering into a Memorandum of Agreement with FSA to promote this program. There are only 16 states that are now participating. If the Agricultural Development Board agreed to fund an application from us, and this is something the KAFC Board wished to pursue we would go ahead and enter into a Memorandum of Agreement with FSA. This would show cooperative efforts between a federal agency and us. It also opens the doors for the Corporation.

He then asked for comments or questions on the First Time Farmer Program. The question was raised as to what First Time Farmer according to the Federal Government means. Which Federal agency is this referring to? Is this the Internal Revenue Service or United States Department of Agriculture? Mr. Bratcher told us that this is part of the issue. Whose definition do we want to use? FSA has a definition for First Time Farmer, they call it Beginning Farmers and Ranchers, and the tax code has a specific definition for First Time Farmer. He is not sure that these are one in the same.

The comment was made that we will have the option to use the one that is most advantageous to the first time farmer because the statute just says, as defined by the Federal Government, without specifying which agency it may be. Mr. Bratcher explained that we would probably go in concert with whatever the FSA regulations are. Our definition is probably more restrictive than anyone else's. We may have to make sure that if we are going to do FSA financing the farmer meets our definition before meeting their definition.

Wayne Hunt asked if this is the same as the old FSA Guarantee. Mr. Bratcher explained that of a $100 thousand deal the farmer would go to FSA for 40% then to his lender for 50% of the financing of which we would participate in. We would be lending ½ of the 50%. He told us that FSA has more guarantee money than direct money. Mr. Bratcher also told us that FSA would guarantee 90% of the bank's loan. If the bank chose to do a 90% financing we would do 45% and they would do 45%. There were questions from the group. Mr. Bratcher explained that of $100 thousand financing, the farmer would put up $10 thousand, the bank would put up $90 thousand, and we would buy down $45 thousand of the bank's loan. The whole $90 thousand would be guaranteed by FSA. The bank would be the originator of the loan; we would just buy down part of the loan. The borrower would have a blended rate. The bank would actually have the mortgage filed on record. Agricultural Finance Corporation and the bank would each have 10% risk on the loan.

There was further group discussion with concerns expressed about how cumbersome the process is for the banks and how we might get the banks to participate in the program. Mr. Bratcher asked Jane Jones about Farm Credit. She told us that they don't have a problem meeting requirements. They have different people working on the loans, so they have the loans worked out in a couple or three days. Mr. Hunt asked her, what is the percentage of their portfolio that is guaranteed loans. She responded 9%. Mr. Hunt commented that it is hard to get participation. Ms. Jones said most of their guaranteed loans are for poultry. Mr. Bratcher asked if they do much in the area of First Time Farmers. Ms. Jones told us that they don't have a lot of First Time Farmers.

Mr. Bratcher referenced the last meeting and commented about a number of farming operations where the fathers would like to get out of farming and other members of the family would like to get in. He commented that this seems to be a program that under the law we could do. There was further group discussion about the definition of First Time Farmer. Mr. Bratcher explained that one of the things we would do to get this program going is promulgate regulations. In those regulations we would set out what the rules of the program would be. We would take into account the other federal programs that are out there and try and make sure, with the exception of the limitation of existing statute, we would come under all three of those various agencies. Annette Crawford Walters said that if we were in partnership with FSA we would have to use their definition. Mr. Bratcher explained that if they are more restrictive than ours we will, but it may be that theirs is more liberal than ours. He explained further. Gordon Duke raised the question of the restrictions on buying property from family members. Mr. Bratcher told us that he believes this is permissible subject to appraisals. Ms. Walters raised the question of owner equity if the selling family member lowers the price for the buying family member. There was some discussion on this with no definite answer.

Mr. Bratcher told us about the Agi-Bond Program. He told us that these are Private Activity Bonds and explained the different entities that use these. He told us that the states are obligated each year to allocate for volume caps for Private Activity Bonds. This is $75 per person times the state population. It will be a little difficult to develop the Agi-Bond Program. There are a lot of variables where we may or may not be able to do the tax exempt financing. This program is out there in statute and it is something we do want to continue to pursue. Right now, for the first time farmer, in terms of a program that could be up and going right now, something along the lines of what we are talking about today is an easier route to go to be able to demonstrate some viable program to try and put together tax exempt financing between now and January.

There are a lot of issues to be addressed. Mr. Bratcher mentioned the Volume Cap issue and told us that the demand for it is usually is over-subscribed. Gordon Duke told us that this is not the case this year. He explained further and suggested that we could just get an allocation of the Volume Cap. He also told that as of July 1 the un-subscribed monies in this program goes into an open pool for everyone. Mr. Bratcher said we might want to look at what we would have to do to get in that July window. Mr. Duke suggested that maybe we would want to look at going for a dollar amount without an individual bond. The question was raised about at least ½ of the farmer's gross income for the past three years coming from farming. There was group discussion then the suggestion that when we write our regulations we can put a definition in for this.

Bob Proffitt asked the question if we are planning to do anything for farmers, not just first time farmers. Mr. Bratcher spoke about the 2nd component of the near term plan - The Investment Fund for Agriculture. We still would be assisting those individuals but through making an investment in a bank, which is making a loan to a farmer. This is essentially the way the Link Deposit Program works. He offered explanation on the Link Deposit Program. Mr. Bratcher told us that we could also use this same type of program for Value Added Processors. He told us about a group from California that wants to develop a fluid goat milk, processing plant on the east coast. He suggested we could tell them that we could provide some of the financing through the investment fund for agriculture. We could still be able to finance farmers through this program by investing dollars in the bank. We would accomplish the same thing while steering clear of this definition in the statute of applicant. There was further discussion within the group. Mr. Duke raised the issue of tying up our funds for the length of the loan. Mr. Bratcher explained further. Sandy Ross explained that if we could sell off that loan we could keep recycling those funds. Mr. Hunt asked how much money we are talking about. Mr. Bratcher responded that if the group is enthusiastic about this program they could come up with a number. He offered that his idea is in the area of $25 million going in. He suggested not allocating particular amounts for particular programs.

Mr. Bratcher explained the 3rd component - The Agricultural Endeavors Lease Fund. In this component we would have the ability to work with value added processors. Using the goat milk example, since KAFC has the authority to own real estate we could actually go to the company and say we will build a building for you and lease it back to you on a capitalized rate and at the end of the lease term you could buy it for $1. Just like you could on any typical industrial revenue bond transaction. We would have the ability to negotiate lease payments however we wanted to. We are going to tie up the funds when we do this. It is conceivable that we would participate with local lenders. In community projects the local banks really rally around on the job creating projects that would be of benefit to their local agricultural community. We could just buy in on this or be the owner of the building. The banks would provide the financing to us and we would remit the payments back to them. We cannot make a loan because of the $50 thousand limit per applicant. We could purchase real estate and lease it back.

Mr. Duke commented on a similar program in State Government where we sell bonds and pledge the lease/rental payments back off of those bonds for the purchase of equipment. He suggested that we could do something like that, where we could pledge the lease/rental payments back to the farmer. That would probably require some legislation. Mr. Bratcher told us that we don't have a project today, other than our goat milk deal that we could present as an example. We feel that legislation in this area is broad enough to allow us the flexibility for these types of projects.

He also suggested that we not wait for another piece of legislation. We have a potential funding source out there with the Agricultural Development Board. We need to go ahead and move toward an application subject to KAFC's decision and try and establish a funding program now. We don't know what the next biennial budget is going to do to the Agricultural Development Fund. We do know we are viable through June 30, 2004.

Bob Profitt asked about the Cattle Processing Plant that was mentioned at the last meeting. Commissioner Smith told us that we have two options. He told us about a group that wants to form a cattle slaughter plant. We have done feasibility studies and talked to people in other states. This has potential but it is a long shot. There are environmental regulations and labor issues. There are a lot of hurdles to overcome. A more viable project is a company who is a cattle genetics company here in Kentucky that's breeding cattle and selling their genetics, particularly on the sire side. They are buying cattle, backgrounding the cattle throughout the state. They have bought a harvest facility in the Mid-West. Their goal and objective is to identify the cattle coming from Kentucky, keep them in Kentucky as long as possible with our high quality forages and some grains, taking them to larger weights before they leave the state. They would then take them directly to the feedlot to be finished and harvested there, bring back the carcasses on the rail then process them here.

Mr. Bratcher told us that the company is Creekstone. Commissioner Smith told us that this company is different from most processors as they are going to be in control the genetics from the time the animal is conceived until it comes back to the plate. The man running this company is a Kentuckian. The future in the meat protein business is going to be in a branded product. Commissioner Smith commented that consumers have been willing to pay a higher price for an identified product that has been managed, bred, health cared, fed and processed under specific guidelines. These folks have figured our how to market every aspect of that animal. Mr. Bratcher told us that they met with them last June and that Bruce Harper met with them in the last few days. Their ultimate goal is a product that is traceable back to the animal itself. Ms. Walters asked if the local farmer would contract with them. Commissioner Smith told us that he believes that there will be certain segments of the state. He feels that there will be several options that the farmers will have. He told us that there is a fear that some small farmers will be left behind. It isn't impossible for them to do this, but there will be some that may not want to. There will be several opportunities. Mr. Bratcher told us that we are seeing some small projects. He commented about a funded project, which is going to do retail cuts of meat for Kentucky cattle in Louisville. He explained that there are going to be several opportunities.

There was some group discussion on the uniqueness of this program. Mr. Bratcher told us that we have some tools in place where we can work with these value added processors. He also told us that we can own real property and personal property, but we cannot own intangible property. Under KRS 247 we have been given the same powers as cities and counties to issue industrial revenue bonds under KRS 103. What that means is that we could serve as an issuer of a tax-exempt industrial revenue bond for a manufacturer/value added processor in lieu of a city/county doing it. He explained further.

Charles Miller commented about building a mechanism where the farmers/producers can have a greater benefit from processors into whatever we do. Mr. Bratcher responded and gave an example of the Milk Producers Association forming an LLC. Farmers are actually going to invest money in the LLC, which would then be a joint venture partner with Glasgow Spray Dry. Charles Miller commented about the cost associated with tracing animals back to the producer and who is going to bear this cost. Commissioner Smith responded telling us that the underlying factor is to provide a market that wasn't here and to compensate the investment of farmers a premium over and above what they can get at the average market. There was some further comments and discussion.

John-Mark Hack told the board that the fundamental tenant of everything KAFC does is the opportunity to position the producer in a place that is different than they were before. What sets the Commonwealth apart from every other state that has engaged themselves in some significantly sized agricultural development or diversification initiative is our commitment to move the producer up the chain to the point of experiencing more net gain than producers do in conventional relationships with processors. The system, as it exists today, is fundamentally flawed in terms of the relationships between processors and producers because it is not financially sustainable on the production end. He explained further that this is what has a lot of people interested on the producer side and what has so many people nationwide interested in what the Agricultural Development Fund and the Agricultural Finance Corporation are doing. There was further group questions and answers.

Capital Access:

Mr. Bratcher told us that the underlying premise is that a banker is going to have a set aside for loan loss reserve. The borrower and the lenders establish a debt service reserve pool. As more and more borrowers who participate, the pool continues to build up. The funds stay there exclusively for the purpose of underwriting losses. These funds would gain interest. Over time a large enough loan loss reserve pool would exist to make loans to people who may not be as fundable. The down side is that we put that money into an entity and we would never see it again. The up side is, if all you are putting in is 2% of a loan, think how many loans you could do with $1 million. Think how many farmers you could impact.

Ms. Ross asked if the reserve doesn't come back after the loan is retired. Mr. Bratcher responded, yes and explained that it stays with the institution and continues to build up. Mr. Bratcher told us that in states that have done this, it has been fairly large institutions that participated. If we try to go this route, it will be under the premise that we are trying to impact farmers who might otherwise not be able to get the capital. Another alternative is we could ask the counties to participate with us with county funds.

Mr. Duke told us that he has talked with a number of people at a national meeting of people who ran this program in other states. It is a program that was primarily set up and designed to deal with small business. The people who have administered this program really like it for it's simplicity, impact and for the participation that comes about as a result of programs for those people who don't currently get the credit. It brings people in who don't have the creditworthiness on their own. Those loans could be for operations, equipment or supplies. The beauty of this program is that it is very easy to administer. He explained the process. He told us that four years ago in California they lent out $480 million in loans of $50 thousand or less. They administer it with one part-time person.

He told us that in one or two states that operate this program the interest income off the states' investments of that money locally gave the states enough money to fund the program the next year.

Wayne Hunt asked about the heavily impacted counties. Mr. Duke said we could offer a greater percentage to the heavily impacted counties. Charles Miller brought up the First Time Farmer question again. Mr. Bratcher said he believes this is an easier program to administer than the loan guarantee program. The group discussed these issues further.

Mr. Bratcher asked if the four areas we have discussed are things that we should have discussed, or should we stay away from some of them. Wane Hunt commented that this is one place that the Agricultural Development Board can impact agriculture on the county level. An Economic Development Fund can be done. Dr. Harold Benson commented that this is a revolutionary opportunity and somewhat out of the box. He made the suggestion that we need to be very purposeful in our packaging of what it is such that the result of this initiative is success. It will then set the trend for agriculture in Kentucky for the foreseeable future.

Mr. Bratcher told us that we want to have some programs that we can get up and going, that are not going to be overly cumbersome. We are probably going to have to promulgate regulations, which will be the most time consuming part of this. We hope to go into the next session of the General Assembly in January or February of next year and show that we have been spending money. Mark Farrow told us that it is very important to be ahead of the next session. Mr. Bratcher suggested that he hopes to have these programs up and going before August.

Mr. Miller told us that it is very commendable for us to take what we have and figured out a way that we can do a lot more with it. He asked if what goes on in the 2004 legislation will impact what goes on here. Mr. Bratcher responded that the key points in HB 541 are primarily definition points. We need to go back and change that definition of applicant to make the farmer contort to federal guidelines. Mr. Miller asked if the program would be in place and this legislation would only enhance it. Mr. Bratcher responded that it would not negate in any way what we are presently doing; we may have to go back and redo the loan agreement to make it comply with the law. Mr. Hunt made the comment that we need to do something and be successful. Commissioner Smith explained that a lot of this can be done under Executive Orders then ask the legislature to confirm it, if they don't approve and confirm you just do it over.

Mr. Duke stated that what we are trying to do is identify the concept and how we can work in concert with the Agricultural Development Board. He expressed the need to identify programs and submit an application. There were further comments from Board members. Mr. Hack told us that the sooner this group can get established and make application to the Agricultural Development Board, the better. He told us that in his opinion, the only thing that is going to be left in terms of available capital to fund agricultural development and diversification projects twenty years from now in the Commonwealth is what this group applies for. This is the sustainable model of agricultural finance development in Kentucky.

Wayne Hunt said determining how much money we are going to apply for is critical. Commissioner Smith told us that in looking at the report, the Capital Access programs that we have in the state now were formed mostly from 1996-1998. Mr. Duke told us the most recent report was in 1999. Commissioner Smith suggested that we look at other states for programs that work and don't work. Mr. Bratcher said that most other states are not doing agricultural programs they are doing small business. There were some additional comments. Mr. Bratcher asked if we want to make our first presentation at the Agricultural Development Board on May 16th. He also asked if we want to circulate a draft to this board before it is presented to the Agricultural Development Board. There was some discussion about making this presentation on Monday April 21st. Mr. Bratcher invited board members to the meeting on April 21st and the Kentucky Opportunity Marketplace. The question was raised whether we could submit an application by the end of April to be reviewed in June. Mr. Bratcher suggested that we try to summit the application by the end of May for review at the July Meeting. He also suggested that we could go ahead and work on the regulations.

Next Meeting Date:

The next meeting is scheduled for 9:30 am on May 14, 2003

Adjorn:

The meeting adjourned at 12:05pm